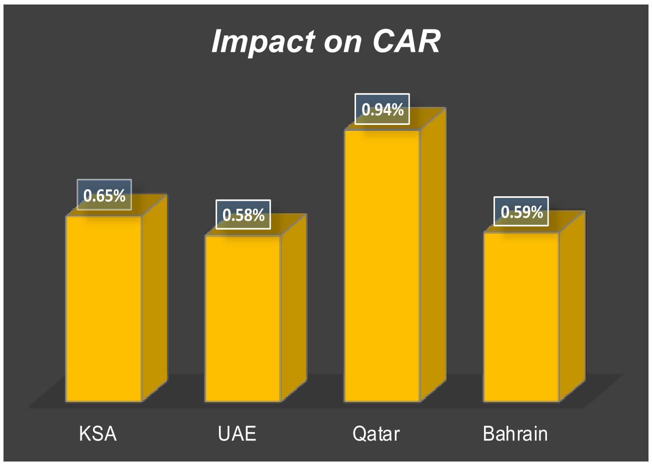
IFRS 9 IMPACT ASSESSMENTS- MORE QUESTIONS THAN ANSWERS

Middle East based banks reveal IFRS 9 impacts but the apparent lack of comparability of numbers across banks makes deciphering numbers a head-scratcher. Further disclosures for Q1 2018 awaited for clarity.

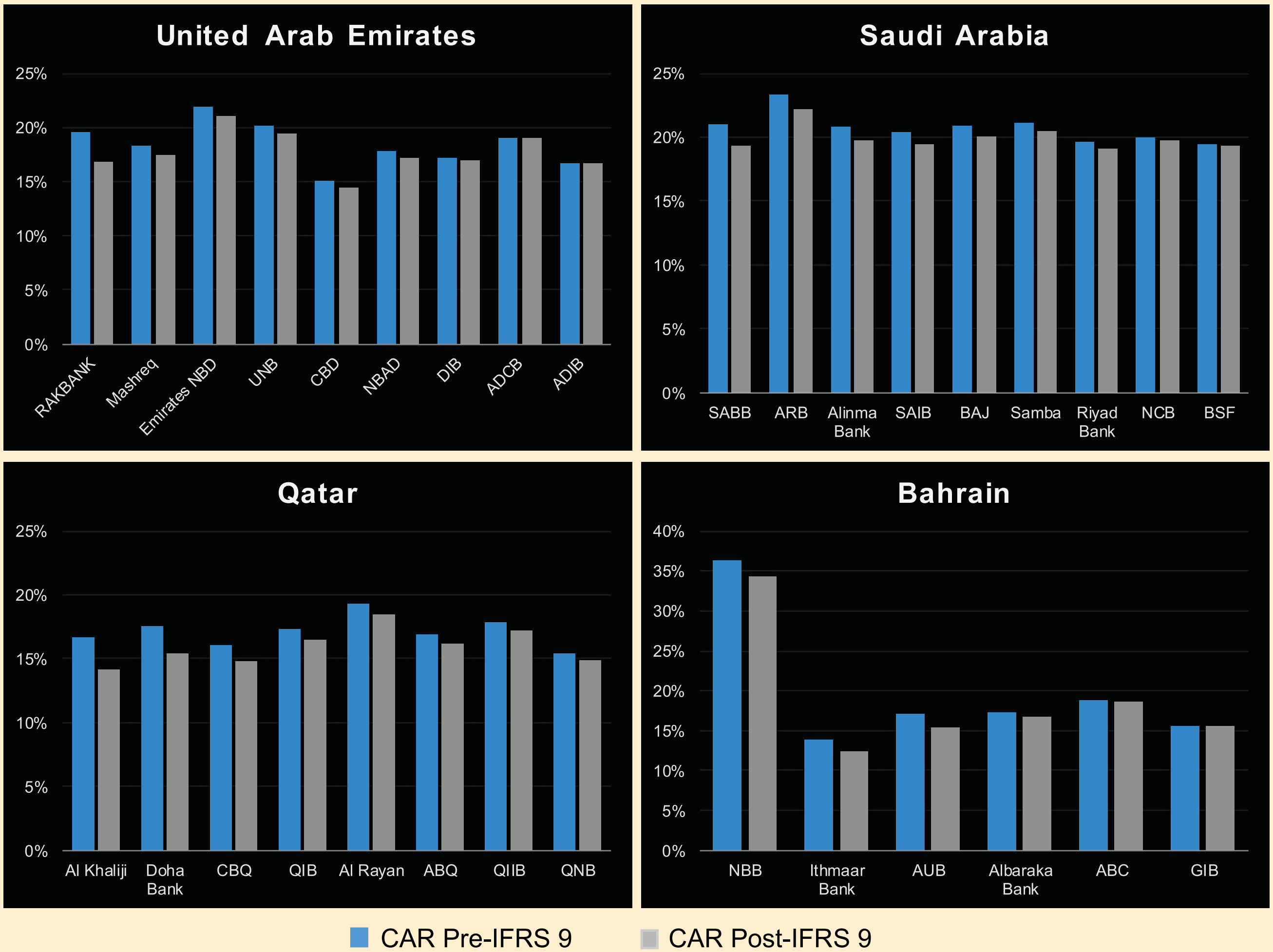
While December 2017 saw the oil industry in the G.C.C were rejoice over an 18% uptick in oil prices from January 2017, the banking sector saw the culmination of year-long preparations for IFRS 9 compliance, with most banks bracing for a negative impact on their balance sheets. This new standard on accounting for financial instruments brings in significant changes to the impairment assessment methodology to address concerns about “too little, too late” provisioning for loan losses. The guidelines accelerate the recognition of losses by requiring the provisions to cover expected losses instead of just incurred losses. While the move to the new regime takes place effective Jan 1st, 2018, banks have disclosed quantitative impacts expected on their books due to this transition. The resultant impairment charge (or Expected Credit Loss "ECL") is expected to erode approximately 3.30% of the total equity of the banks across Saudi Arabia, UAE, Qatar and Bahrain. Qatar with an impact approximating 3.83% of the total equity is marginally higher than the others. The ECL however shows a degree of variability between banks. IFRS 9 being non-prescriptive in the methodology for estimation of ECL, the plausible explanation is that banks have adopted varied approaches leading to a not-so-easy comparability across peer banks. This is a distinct change from the earlier regime, which was more or less rule-based and relatively easy to decode as well as to attribute numbers to portfolio sizes and levels of non-performing assets.

On an average, the resultant impairment charge is expected to erode 3.30% of the total equity of banks

Of the banks in the sample chosen, almost all banks demonstrate an increase in the provisions under the ECL regime. On careful analysis of the ECL impact on equity, it is observed that the smaller banks have experienced larger impact of ECL on equity as compared to the larger banks. In Saudi Arabia, banks holding total equity of 32% have witnessed an average impact of 3% of ECL on equity whereas banks holding 7% of total equity have witnessed an average impact of 5% of ECL on equity. Similarly, in UAE, the top two banks constitute 54% of the total equity with an average impact of 3.5% of ECL on equity whereas, the three banks constituting 13% of total equity have witnessed an average impact of 7% on ECL. Qatar also depicts a similar trend with the top four banks witnessing an average impact of 4% of ECL on equity as compared to the bottom four witnessing double that. The ECL impact on banks' equity in Bahrain has been on a higher side in general with three exceptions. Two of the mid-sized banks in terms of equity in Qatar have reported provision impact on equity as high as 12% while one has reported a corresponding impact of 1%. Similarly, in UAE, the impact of ECL on equity ranges from 0.45% to 12%. As seen above, there is significant variability in the ECL impact on equity among banks.

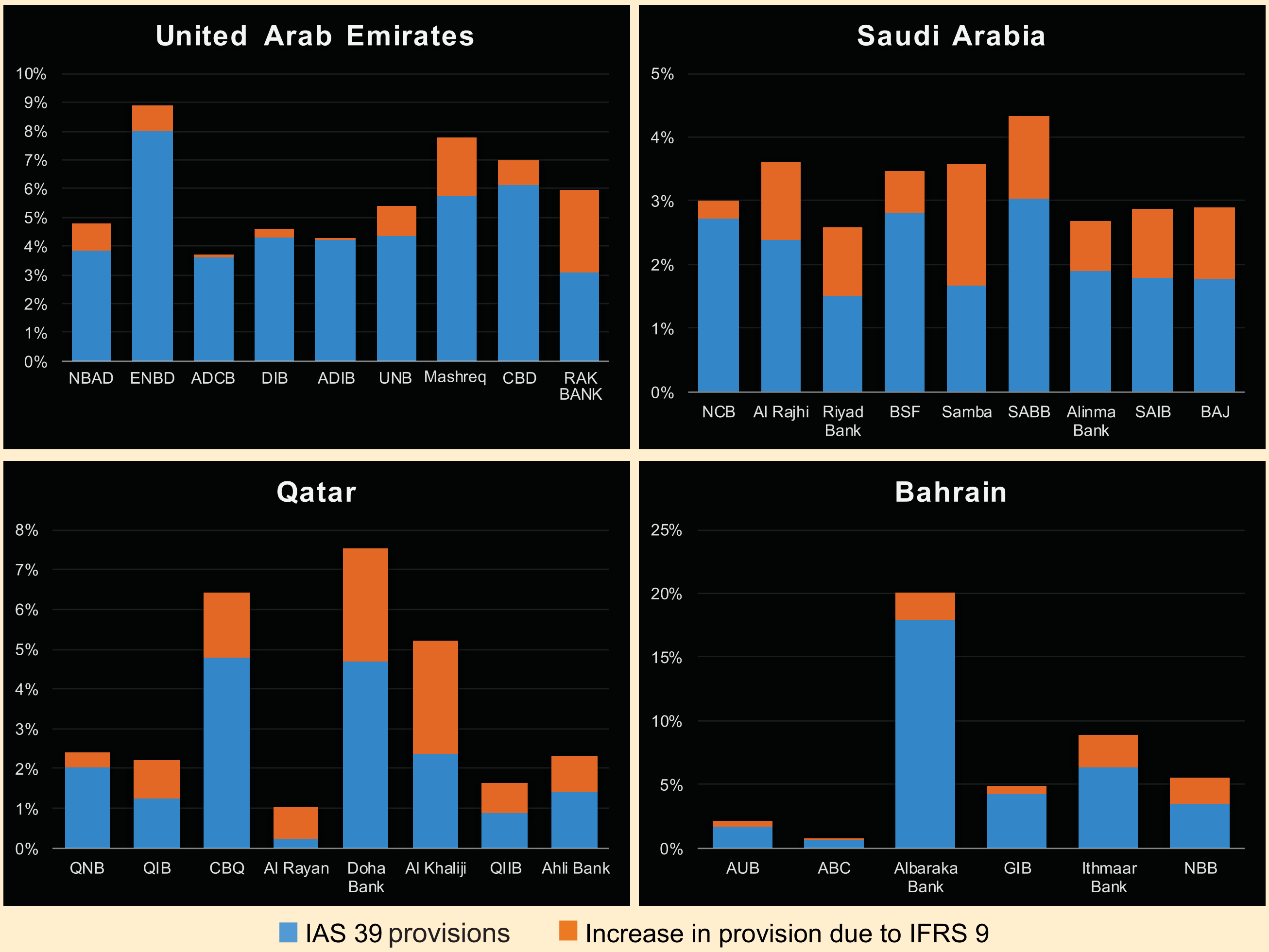


Bank-wise impact of ECL on CAR (in decreasing order of reduction in CAR)



Bankers across the region have explored multiple options and approaches for estimation. Managing the possible impact on equity at the same time ensuring coverage for possibility of expected credit losses left the risk managers and accountants at cross roads. Adding to the above is the impact of 0.69% on the CAR of the banks in the region. The country specific numbers are within the range of 0.5% to 1%. Qatar with a total impact of 0.94% is the most impacted. The BCBS paper on ***'Regulatory Treatment of Accounting Provisions'*** provides an option to banks to absorb the impact of ECL on CAR over 3 to 5 years. Most banks would naturally prefer to take the impact across a period of several years, and await their respective regulator's guidance in this aspect.

Bank wise ECL as a percentage (%) of Total Loans & Advances



The average provision coverage ratio has increased by 28% across the four countries. The increase has been highest for Qatar and Kingdom of Saudi Arabia. The impact of ECL for most of the Banks in UAE has been up to 2% of the loans and advances whereas, the impact on banks in the KSA have been highest. In Bahrain, the impact of ECL has been in the range of 1% to 4% of loans and advances (L&A). The region as a whole is looking at an increase in provision, impacting the accumulated profits by 14.28%. The overall provisions under IFRS 9 have remained to be around 3.96% of the loans and advances.

The marked variability in numbers poses a particular conundrum for the regulators – how do they ensure that numbers are not 'gamed' and yet not do away with the 'principle' driven nature of the guidelines. How does one ensure the integrity of the numbers, and that banks are not engaging in methodology-arbitrage? Given the subjectivity across ECL models among banks, there is a need for banks to be able to demonstrate appropriateness of methodologies used and design a robust model governance framework.

Country	% Increase in Provision	Impact on Retained Earnings
KSA	37%	17%
UAE	15%	8%
Qatar	38%	21%
Bahrain	29%	10%

Key developments to watch out for

- Considering the principle driven nature of guidelines, it remains to be seen if some banks revise their estimates in Q1 2018
- Increased emphasis on reviewing the ECL models and governance to manage model risk.
- The quality of IFRS9 implementation at banks will be assessed by stakeholders via the coverage and depth of the quantitative and qualitative disclosures
- The Central Banks may alternatively prescribe minimum set of qualitative and quantitative disclosures which could ease comparability of numbers across banks.

Keep watching our LinkedIn handle or website for our next edition in May 2018 where we will provide in-depth assessment of IFRS9 impact across GCC banks once actual numbers are published by the banks.

Please send your suggestions and feedback in this regard at IFRS9.Insights@aptivaa.com

Assumptions and Limitations

- It would be pertinent to point out that the charts and numbers rely on disclosures as of 31st December 2017 financial statements, the non-standardization in metrics disclosed by banks, has resulted in us using several approximations
- Actual numbers will start being available with the first quarter results of 2018, and all banks have clarified that actual numbers could vary from numbers presented in the impact assessment, as methodologies are in the process of being finalized. In such cases where banks have provided the impact as a range, the mid-point of the range is assumed as the impact, which admittedly is a significant approximation.
- Also significant assumptions are made to compute impact on Equity and Capital Adequacy Ratio in case those numbers aren't provided directly by banks as part of the impact assessments.
- The analysis is based on a sample set of banks from Saudi Arabia, UAE, Qatar and Bahrain.
- For our analysis as represented in this document, we have used publicly available information obtained from sources we generally believe to be reliable; however, accuracy cannot be assured. We are not giving an opinion or any other form of assurance on information from these sources. Unless otherwise noted, the values calculated by us are derived using applicable market data parameters and generally accepted valuation methodologies.
- For our analysis, while calculating total current provisions, we have considered collective/general provisions and specific provisions. Any additional reserves have not been considered.

Feel free to send your queries to:

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About Aptivaa

Aptivaa is a vertically focused finance and risk management consulting and analytics firm with world-class competencies in IFRS 9, Basel III, Credit Risk, Market Risk, Operational Risk, IRRBB, Risk Analytics, COSO, ALM, Model Risk Management, ICAAP, Stress Testing and BCBS 239 (Risk Data Aggregation & Reporting) etc. Aptivaa has emerged as a leading risk management solutions firm having served over 100 clients across 22 countries comprising of highly respected names in the financial services industry.

We can help you through our bouquet of IFRS 9 related offerings listed below:

- Aptivaa has a suite of proprietary tools & framework that are designed to accelerate IFRS 9 implementation in areas such as Life of loan estimation, PIT-PD Calibration, Lifetime-PD, LGD, Lifetime EAD, Lifetime ECL estimation, Q factor adjustments and disclosures.
- Rating and IFRS 9 Models Risk Management and Validation Solution (MONITRO)
- IFRS 9 ECL Solution to allow migration of excel spreadsheets model and rules to a robust and powerful IT platform to be able to do on the fly what-if analysis, multi-scenario ECL runs and automatic attribution of results of two different ECL runs
- Alignment of IFRS9 and ICAAP/Stress Testing Models
- Risk based pricing of loans with our easy-to-customize RAROC toolkit

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